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BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C.

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In the Matter of	)	
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	

REPLY COMMENTS OF WILTEL, INC.

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SUMMARY

The LECs' requests for increased pricing flexibility, if granted, would effectively result in the deregulation of LEC access pricing in a market in which they today possess, and for the foreseeable future will continue to possess, market power with respect to virtually all services regulated by the FCC.

The Commission must test the LECs' requests for sweeping pricing flexibility against the realities of the access market, both today and in the future. Far more than transport pricing for interexchange carriers is at stake. The LEC network is increasingly made up of high capacity fiber optic transmission facilities and large multi-purpose switches. LEC incremental costs are relatively low, and common costs and overheads are relatively high. Without protections against price discrimination, LECs have both the incentive and the ability to recover those common costs from customers who lack competitive alternatives, and to discriminate in favor of themselves, or their highest volume customers who are more likely to have competitive choices.

Significantly, the only part of the interstate access market that is even potentially competitive is special access and transport. And even those services -- particularly tandem-switched transport -- are far from competitive today. More fundamentally, transport revenues make up less than 10 percent of LEC interstate switched access revenues. The balance of switched access revenues under the Commission's jurisdiction -- those attributable to use of the subscriber loop and end office switching -- will not be subject to competitive pressures, even if there is local loop competition. This structural problem exists because the end user will select its loop provider based on the price and quality of <u>local</u> service. The access customer then has no choice but to pay the end user-designated loop vendor's charges for

access. In short, the access customer will have no greater competitive choice than it does today.

Viewed against this backdrop, it is clear that the USTA proposal, which is supported by many of the commenting LECs, must be rejected as excessive and unnecessary. USTA's proposal to abolish virtually all basket and band protections under price caps would award the LECs a license to discriminate almost without limit. USTA's proposal to garner additional pricing flexibility on a wire center by wire center basis completely ignores the fact that competitive offerings will be available for only some of the services offered by a LEC from a particular wire center. USTA's "addressability" test also disregards whether, as a technical or economic matter, all LEC customers in a particular wire center in fact have competitive alternatives.

The LECs also argue that the FCC's infrastructure and economic development goals would be furthered by elimination of sharing requirements and grant of substantial pricing flexibility. But there is no connection whatsoever between infrastructure investment and LEC price deregulation. LEC price discrimination could in fact interfere with achievement of the full potential of the information superhighway. The best way to achieve economic growth, and to stimulate demand for infrastructure construction, is to ensure that LEC network services are priced in a way that will encourage a diversity of service providers to use the LEC network through non-discriminatory access pricing.

Grant of further LEC pricing flexibility would not only be bad public policy, it would also violate the Communications Act's requirement that rates be just, reasonable, and nondiscriminatory. The USTA plan effectively would permit LECs to engage in market-based pricing, which is not lawful for carriers, like the LECs, who have market power. Similarly, it would be unreasonable for the FCC to lift the obligation that LECs share some of their excess earnings, which are largely derived from monopoly services, with ratepayers. To ensure that rates under price caps satisfy the Act's requirements, the FCC instead should build into the price cap plan additional protections against discrimination and unreasonable pricing.

Finally, the FCC should reject LEC requests to dilute the new services test even further. Instead, the FCC should strengthen the test by adopting uniform costing principles to ensure that LECs will not discriminate in the allocation of common overheads to different services and to prevent LECs from flowing through cost reductions only to LEC customers that have competitive alternatives.

In sum, the FCC must deny the LECs' requests for even greater pricing flexibility, and instead head in the direction of building greater protections against discrimination. The Commission should take advantage of this opportunity to put in place safeguards that will ensure the development of open, competitive, and diverse telecommunications markets in the future.

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REPLY COMMENTS OF WILTEL, INC.

WilTel, Inc. ("WilTel"), by its attorneys, hereby submits its reply to the comments of other parties filed in response to the Notice of Proposed Rulemaking in the above-captioned proceeding, FCC 94-10 (released February 16, 1994) ("Notice") considering changes to the price cap rules applicable to local exchange carriers ("LECs").

In its opening comments, WilTel focused most of its attention on the dangers of LEC price discrimination and the need to adopt safeguards to address that discrimination within the context of the price cap plan. In these reply comments we address the LECs' view that the Commission should head in the opposite direction, and lift many of the remaining price cap constraints, in anticipation of the arrival of local competition.

The premise of the LECs' requests for increased pricing flexibility is that local competition will eliminate the need for restrictions on LEC pricing. They argue that competition itself will constrain LEC pricing and ensure that LEC rates are lawful. They also argue that they must be able to readjust prices beyond the current bounds of price caps in order to avoid losing large quantities of business to alternative service providers.

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This view of the market is overly simplistic on its face. First, the Commission must keep in mind that -- for structural reasons -- over 90% of switched access revenues will never be subject to competition. The Commission therefore must ensure that its price cap rules prevent discrimination in the recovery of that revenue, and that the LECs are required to share (again, on a nondiscriminatory basis) the declining cost of providing switched access.

Second, the LECs exaggerate the extent of competition that is likely to develop in those access submarkets that even in theory can become competitive -- special access and interoffice transport. The LECs completely ignore the enormous opportunities that exist in these submarkets for discrimination in the recovery of common network costs. 1/ They ignore their increasing incentives to discriminate: (1) their incentive to maximize profits through price discrimination among IXC access customers with differing levels of competitive choice; (2) their incentive to shift common costs away from services where they face incipient competition to block entry; and (3) their own plans to provide competing interexchange services themselves using their own access facilities. Finally, the LECs ignore evidence that they already are discriminating in the recovery of common costs today. 2/

The Commission should test the glib and predictable LEC requests for deregulation against the reality of the access market that the Commission regulates. When it does so, the Commission will recognize that public policy

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1/ The cost characteristics of the LEC network leave the LECs wide room to discriminate in the recovery of common costs. The LEC network increasingly is made of high capacity fiber optic transmission facilities and large, multi-purpose digital switches. Variable costs are low, while fixed costs and common overhead costs are high. These cost characteristics leave the door wide open for LEC price discrimination against those customers with few or no competitive alternatives.

2/ These issues are discussed in detail in the initial comments of WilTel filed May 9, 1994.

interest in a vibrant telecommunications industry require increased vigilance to prevent discrimination in the cost of access to the national information infrastructure. Put simply, LECs should not be given the power to decide who can use the national network and who cannot through discrimination in the recovery of common network costs -- either discrimination in favor of the LECs' own affiliates, or discrimination in favor of some third party customers over others. These matters are discussed in more detail below.

I. THE LARGE MAJORITY OF SWITCHED ACCESS WILL NEVER BE SUBJECT TO COMPETITION.

Given the LECs' broad-brush requests for further deregulation based on the specter of "local competition," it is important to understand from the outset that "local competition" and "access competition" are not the same thing. Access competition exists when access customers -- IXCs and others -- can make an affirmative choice among vendors for service that extends their network within the local exchange. Local competition, on the other hand, exists when an end user can choose among vendors for its local loop and local exchange service.

This is a crucial distinction because it demonstrates the limitations of access competition, especially interstate access competition subject to this Commission's jurisdiction. Access customers can extend their networks just so far using a vendor of their own choice, even assuming that such a choice even (or ever) exists. They can in theory select an "access vendor" up to an end user's central office. But after that it is the end user who chooses the "exchange carrier" to connect its premise to the end office. And significantly, the end user generally will make this decision based on what it pays for its loop and local service, not what the loop vendor separately charges access customers for their use of the loop. The access customer, in short, must live with the loop decision made by the end user. Local competition therefore does not enhance access competition in any material respect.

In the next section WilTel discusses how the LECs have overstated the existence of access competition now and for the foreseeable future. But for present purposes it is important for the Commission to recognize that -- even in theory -- market pressures only can influence the pricing of interoffice transport and special access. These are the services that are potentially subject to access competition because they are within the decisional control of access customers. 3/ Local competition will not have any influence on remaining switched access service -- the charges imposed on an IXC for using the local loop selected by the end user.

Significantly, these remaining bottleneck switched access services make up fully 90% of the LECs' switched revenues today. As shown in the Appendix to these comments, interoffice transport services that nominally could be open to access competition make up less than 10% of total interstate switched access revenues. In all other cases the IXC still will face the same bottleneck it does today. In order to sell service to an end user, or terminate service to an end user, the IXC will have no choice but to pay the access charges imposed by the loop vendor selected by the end user for reasons that have little or nothing to do with access charges.

WilTel is not alone in identifying this fundamental structural problem in the interstate access market. In its comments, MCI observed that "local

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3/ By this we include dedicated access to a customer premise that in principle an end user could order at the behest of an access customer such as an IXC, or allow the IXC to order and connect. Even here, however, the role of the end user as consenting party is significant. If the end user only wants to use local service provided by the traditional LEC, the IXC must live with that decision.

exchange carriers -- LEC or otherwise -- continue to hold the bottleneck access between the IXC and end users." MCI Comments at 78. As MCI described it, local competition is likely to develop in such a way that:

> [E]nd users will always select the provider of those two services [loops and switching] on the basis of the prices charged for local service, and not the access prices the long distance carriers must pay. In fact, competition for local service may result in access prices being set at a level well above cost. Id. at 79.

WilTel also agrees with MCI that local service providers will have "the incentive to compete for local service customers by charging low local service rates while recovering the remainder of their costs from access customers." Id. at 78. Those access customers will not have competitive choices, and LECs will have the incentive to overcharge them -- and will also have the ability to do so, unless the FCC has in place protections against unreasonable and discriminatory access prices.

We are not saying that local competition is pointless. On the contrary, subscribers should benefit if a market develops that permits them to have multiple choices for their local service provider. But local competition is competition only from the point of view of the end user. Once the end user has chosen its loop vendor, that vendor still has conventional market power over an essential facility required by other vendors to access the customer. 4/

4/ It is possible that some day a technology could be developed that would permit an end user to originate its traffic over different subscriber lines depending upon which service provider it intends to reach, much as a PBX might be able to route calls over different trunk lines provided by different local service providers. But such a technology is not at hand. Even if it were developed, every local service provider still would have to wire every subscriber, and someone would still have to pay for each loop and for the PBX-like technology. WilTel submits that for the foreseeable future the likelihood is remote that end users will voluntarily subscribe to a second line (other than perhaps a nonwireline service used for mobile

This structural reality of the telecommunications market ensures that the Commission will have an ongoing role to play in regulating interstate access for the foreseeable future. The Commission must improve the price cap rules to ensure, first of all, that the LECs always are required to recover for the use of their local loops and switching for interstate access on a nondiscriminatory basis. They must not be given flexibility to charge less to some access customers than others. For example, volume discounts of these traffic-insensitive facilities must not be allowed, and price caps must not be redesigned in ways that permit LECs to introduce such discounts. Second, the Commission should ensure that LECs adequately reflect the declining costs of providing switched access service. Third, any "public policy" subsidies to be recovered in this process should be carefully specified and similarly recovered on a nondiscriminatory basis.

This issue is of crucial importance to WilTel because these non-competitive switched access charges are now and will remain our largest single cost of doing business. The Commission must resist any suggestion whatsoever by LECs that local competition reduces their market power with regard to these services and justifies pricing flexibility in the recovery of these switched access costs. Any discrimination in this area would be both contrary to cost-based pricing principles and devastating to competition. In those circumstances LECs would declare winners and losers in the telecommunications market through their pricing of access to their customers' local loops.

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telecommunications) where one line is sufficient today. In any event, such technology still would not solve the problem of terminating access, which as a practical matter still would remain noncompetitive from the point of view of the access purchaser.

II. THE USTA PLAN AND OTHER LEC REQUESTS FOR PRICING FLEXIBILITY ARE PREMATURE, AND FAIL TO ADDRESS THE NEED TO ELIMINATE DISCRIMINATION IN THE RECOVERY OF COMMON LEC NETWORK COSTS.

A. Discrimination Remains a Crucial Problem Due to LEC Market Power.

Once the Commission sets aside the 90% of the interstate switched access market that will never be competitive, it can separately consider how price caps can be reformed to improve regulation of special access and interoffice transport that at least in theory may become competitive because access customers can choose the access vendor. The principal problem in this area is that competitive choices for access customers are likely to develop irregularly, at different speeds for different customers and in different locations. As other parties have shown in their opening comments, today the LECs still have about 99 percent of the interstate access market, and face competition only in very limited geographic areas and service categories. 5/ Competitive alternatives for direct-trunked transport, channel terminations and special access exist in only selected end offices. Moreover, the recent judicial reversal of the FCC's expanded interconnection decision has raised questions about the viability of existing and future interconnection arrangements. 6/

5/ See, e.g., MFS Comments at 39. As we discuss more fully below, just because a LEC faces competition for some services in a limited geographic area does not mean that the entire market, even in that limited geographic area, is competitive. As the Commission recognized in the Notice, LECs have the incentive and ability to discriminate in favor of customers with competitive choices and against customers without such choices. Notice at para. 80.

6/ Bell Atlantic Telephone Cos. v. FCC, D.C. Cir. No. 92-1619 (June 10, 1994).

Overhanging the issue of access regulation is the fact that today and for the foreseeable future users of tandem switched transport service have no competitive alternatives whatsoever to the LEC, and therefore tandem service is the natural "dumping ground" for a disproportionate share of LEC common costs. This is true notwithstanding the Commission's recent decision to require LECs to offer tandem signaling information. Tandem competition typically will not be an economically viable alternative because competitors will not be able to aggregate sufficient traffic from every end office in a region to warrant trunking to those offices and installing an additional tandem switch. In contrast, the LEC currently obtains this level of traffic by providing virtually all IXC access in addition to all local and intraLATA toll traffic. It is doubtful whether an alternative provider could achieve similar economies, especially in medium and low-density traffic regions.

The dangers associated with LEC pricing flexibility extend far beyond transport and far beyond the long distance market. New competitors to traditional LEC services are now emerging to provide competing local telephone service, wireless services, information and intrastate toll services. The LECs, in turn, are now providing video dialtone services and in some cases video programming services; the BOCs are pressing to be allowed to provide interLATA services. The LECs argue that such marketplace changes require the FCC to undo as many constraints on LEC pricing as possible. But precisely the opposite conclusion should follow from the breakdown of market barriers. LECs will have an even greater incentive to discriminate for strategic and anticompetitive reasons than ever before. The FCC must build safeguards into its price cap plan to ensure that LECs do not have the ability to favor their largest customers -- or themselves, if they are providing competing long-distance, information, video, mobile, or other services --

and to discriminate against service providers with the fewest competitive alternatives. Only with these protections in place will these markets develop in the most open and competitive manner.

For these reasons, the Commission should reject LEC requests for additional pricing flexibility as premature at best. Instead, the Commission should improve LEC price caps to eliminate discrimination in the recovery of common network costs, discrimination that unfairly and unreasonably makes access to some networks and services more expensive than others -- and thereby directly interferes with the workings of a fully competitive market.

B. The USTA Plan Would Vastly Increase LEC Opportunities for Discrimination.

Many of the LECs commenting in this proceeding have endorsed the USTA proposal for giving the LECs increased pricing flexibility under price caps or have proposed similarly sweeping changes to the price cap plan. The USTA plan would (1) abolish virtually all basket and bands limitations under price caps; (2) allow LECs to have even greater flexibility, including lifting price cap restrictions altogether, on a wire center basis as "competition" arrives; (3) eliminate Part 69 access charge rules, with the exception of "public policy" elements; and (4) "simplify" the treatment of new services.

When read in conjunction with USTA's related request to lift sharing obligations, this proposal is nothing more than a blatant attempt on the part of the LECs to obtain increased profits at the expense of competition and customer welfare. USTA is asking the Commission to award the LECs a license to discriminate -- or more accurately, to broaden further the latitude they already have to price services based on strategic considerations that have no relationship to cost.

The most striking flaw in USTA's plan is its skewed view of telecommunications markets and competition. The plan completely ignores critical differences in the types of services used by different access customers and the degree of competition that may develop for those services. USTA assumes that appropriate price regulation for the LECs can be defined based on geography alone with no reference to crucial technical and economic factors that control whether or not an access customer must rely on LEC-provided services. Under USTA's proposal, access buyers who lack competitive alternatives are completely at the mercy of the LEC.

First, USTA proposes that virtually all basket and band limitations under price caps be abolished. Under USTA's plan, only three baskets would remain: transport, switching, and public policy. See USTA at 67. Within these broad service categories there would be no limit on a LEC's ability to discriminate by increasing prices paid for customers that lack competitive alternatives to LEC services while lowering prices to customers that are viewed as more likely to change service providers. LECs would simply shift a disproportionate share of the common cost burden from the latter to the former.

In the previous section WilTel discussed why "public policy" (which apparently includes local loop costs) and switching are not competitive access services. But even with respect to transport, the existing price cap basket and band limitations have been demonstrably ineffective in preventing LEC discrimination and cross-subsidization. As we demonstrated in our comments, LECs already have significant freedom to implement market-based pricing distinctions that cannot possibly be justified by any underlying differences in cost. Because access is an essential and proportionately large cost input for IXCs, this type of discrimination has a direct adverse effect on competition in the interexchange market. Yet USTA asks the Commission to remove even the limited protection offered by the basket and band indexes without implementing any safeguards to take their place. This is clearly a recipe for disaster in the interexchange marketplace -- it would allow the LECs to pick winners and losers in that market based on the LECs' desire to protect their revenues, not on the efficiency or service quality of the respective IXC.

USTA would not stop there, however. It proposes further measures that would allow LECs to obtain even more pricing latitude. Specifically, USTA argues that LECs should be permitted to establish geographic zones that qualify for expanded pricing flexibility based on the existence of potential local competition. USTA suggests that the competitiveness level of an end office should be determined based on the concept of "addressability." According to USTA, addressability focuses on "observable fact - the physical presence of alternative providers with the capacity and geographic coverage to serve a substantial portion of the market." See USTA at 63. USTA denies that this test is simply a restatement of the "excess capacity" test advocated by AT&T in its price cap proceeding (USTA at 61-62), stating that addressability also takes into account the alternative providers' ability to deliver services to the customers' locations. See id. at 63 n.168. However, it is clear that in fact "addressability" suffers from the same basic defect as does the "excess capacity" test. It views competition purely from the supply side, without considering whether customers are realistically able to take advantage of alternative sources of supply.

Obviously, the physical presence of an alternative supplier with available telecommunications capacity is a necessary but not sufficient condition for an access customer to switch providers. Instead, the customer will be in a position to obtain access from a LEC competitor only if the competitor provides a service that is technologically and economically comparable to the service the customer buys from the LEC. The USTA "addressability" test, however, completely disregards both technological and economic considerations. Thus, contrary to USTA's assertion, the test clearly does not indicate whether the customer has "real alternatives available." Id. at 62.

The specific criteria USTA proposes for classification of wire centers make this point even more evident. USTA suggests that a wire center be considered a Transitional Market Area ("TMA"), and thereby qualify for additional LEC pricing flexibility, when there is "an operational expanded interconnection arrangement within the wire center." Id. at 65. Under this test, if AT&T decides to collocate at a wire center in order to provide its customers with special access services, the pricing of all LEC access services at that wire center (both special and switched) would be subject to USTA's more lenient TMA rules. LEC pricing flexibility would increase even if AT&T refuses to sell access to its IXC rivals or offers such service only at prohibitively high rates.

The test for reclassifying a TMA as a Competitive Market Area ("CMA") is similarly flawed, focusing on whether some customers have an "available" alternative source of supply and "actively seek to reduce the cost of their access services." Id. Again, there is no mention of the technical characteristics of the services being offered by the alternative supplier or the price of those services. Yet once USTA's criteria are met, all LEC services in the wire center would be removed from price caps completely.

USTA's claim that its wire center-specific approach to implementing added LEC pricing flexibility will "minimize[ ] the possibility of unreasonable price discrimination against customers without competitive alternatives" (id. at 59) does not even pass the straight face test. Implicit in the USTA proposal is the acknowledgment that competition will develop gradually. Under the plan, an end office can qualify as a CMA and become completely exempt from price caps even if customers representing 75% of the access market have no competitive alternatives. Yet the plan contains no measures to protect those customers, who will continue to depend on LEC services. Instead, the plan would permit LECs to finance rate cuts for customers who have competitive options by raising rates for customers who do not.

The USTA plan would be fair only if all LEC access services offered in a wire center were interchangeable, and the same degree of competition existed for all of them. But if that were the case, there would be no justification for any price differentials among the LEC's access services.

In short, the USTA plan would take the Commission in exactly the wrong direction. The LEC price cap rules require new safeguards against discrimination in the recovery of common costs, not elimination of the ineffective checks that exist now. The only way to curb the potential for discrimination that is inherent in the USTA plan is to adopt price indexing, as recommended by WilTel in its comments, or some similar mechanism to ensure nondiscrimination in the recovery of common access costs across LEC services. Such a rule is essential to protect access customers that cannot realistically take advantage of alternatives to LEC-provided service.

III. Adoption of the LECs' Pricing Flexibility Proposals Would Impede, Rather than Promote, Achievement of the FCC's Infrastructure Goals.

The Commission properly should evaluate the parties' requests for changes to the price cap plan in light of the overarching goals of promoting economic development through investment in telecommunications networks. But the FCC must reject the LECs' claims that these goals would be achieved by eliminating sharing and by increasing LEC pricing flexibility. As we explain below, the LECs have failed to establish anything more than a theoretical (and implausible) connection between infrastructure investment and LEC price deregulation. More importantly, increased LEC pricing flexibility actually would have the effect of inhibiting, not encouraging, infrastructure development and economic growth. Expanded pricing flexibility would allow LECs to discriminate against smaller users of the shared LEC network by forcing them to bear disproportionately the common costs of that network. Removal of constraints on pricing also would harm competition in telecommunications markets, both by favoring larger players and by making it difficult for new entrants to compete against the LECs. The net effect would be to dampen incentives for development of vigorous telecommunications networks and to impede the stimulation of new job creation, which most often occurs in small businesses, not large.

The LECs' infrastructure arguments are clouded by a great deal of rhetoric. They argue, first, that if the FCC were to lift limits on price cap earnings and make the basic price cap formula more generous, the LECs would somehow then make massive investments in telecommunications infrastructure and thereby create new jobs. But there is absolutely no requirement that the LECs use their extra earnings to invest in their networks. They could just as easily use that money to invest in foreign countries or in businesses unrelated to communications. 7/ Moreover, the truth is that price caps provides incentives to cut costs, not to add to costs, and to cut jobs, not increase them -- and price caps already has led to that result. Price caps does provide incentives for network investments, but only for

7/ We do not suggest that the FCC should require the LECs to invest in any particular technology in return for higher earnings. Investments should be based on market demand; if they are not, they may be wasted if demand does not materialize or technology changes unexpectedly.

investments in technology that is efficiency-enhancing or cost-saving. Price caps does not necessarily provide incentives for any other infrastructure upgrades.

Second, the LECs argue that they must have increased pricing flexibility under the price cap plan if the Commission is to accomplish its goals of infrastructure development and economic growth. But there is absolutely no connection between pricing flexibility and incentives to invest in telecommunications infrastructure. Pricing flexibility allows the LECs to maximize their revenues by engaging in price discrimination and allows them to strategically price services. But increased pricing flexibility does not and will not necessarily lead to more investment in the network. And price discrimination will actually chill the full use of the LEC network by others.

For the most part, the LECs already have ample network capacity over which to provide new telecommunications services. To the extent they seek incentives to invest in new broadband facilities to the home in order to provide entertainment services, pricing flexibility would only create incentives to make such investment if it allowed telephone ratepayers to subsidize such construction. Finally, as we discuss more fully below, the new services test does not inhibit LECs from introducing new services or investing in the network.

The best way to promote economic growth is to ensure that LEC network services are priced in a way that will encourage a diversity of service providers to develop and to use the LEC network facilities. Most new jobs are created in smaller businesses. If the LEC network is too expensive for new entrants to use, or if LEC pricing inhibits the ability of new competitors to enter the markets for telecommunications, information, and video services, then the Commission's infrastructure development goals will be thwarted, and the full potential of the information age will not be achieved.

If the FCC is serious about wanting to influence the development of the information superhighway, then it must reexamine the kind of pricing flexibility already built into the price cap scheme. The LECs are able today to make large price changes that substantially alter the rate relationships that existed going into price caps without violating a single price cap band or service category restriction. 8/ This existing flexibility allows LECs to engage in price discrimination against customers with fewer or no competitive alternatives, and to favor the largest users by giving them deep volume discounts. The existing price cap plan also permits LECs to engage in anticompetitive pricing without paying a penalty or raising eyebrows.

The best way to ensure maximum buildout of the information superhighway and the maximum use of that highway is to encourage the development of competitive telecommunications markets and to ensure that consumers will continue to have access to a wide range of competing service providers -- whether local, long-distance, wireless, video, or multimedia. Consumer demand for the widest possible array of services will be the best stimulus for the construction of advanced telecommunications networks. The Commission therefore should strive to set the stage for a "Jeffersonian network," with large and small service providers equally able to sell to all customers. This scenario is unlikely to occur, however, if the FCC accepts the LECs' proposals to lift virtually all constraints on LEC pricing and earnings under price caps. Rather LECs must be prohibited from discriminating against new and smaller competitors in the recovery of common costs.

8/ WilTel included a concrete illustration of the wide pricing flexibility already built into the price cap plan in its opening comments, citing dark fiber and DS3 pricing. See WilTel comments at 19-20.

IV. LEC Proposals Undermine the Ability of the Commission to Enforce The Communications Act

The LEC requests for pricing flexibility in this docket are so extreme that, if adopted, they would completely undo the protections that are minimally necessary to make price cap scheme lawful under the Act for carriers with market power. In adopting the original price cap plan, the Commission recognized that to some degree, rates might depart from costs because the direct link between costs and rates present under rate of return regulation had been severed. But the Commission did not intend, in adopting a price cap regulatory scheme, to abandon its statutory obligation to ensure that rates are just, reasonable, and nondiscriminatory. 9/ On the contrary, the Commission believed that a price cap approach was fully consistent with that goal -- but only with protections such as baskets, bands, and service categories. In WilTel's view, more such protections are needed now that the equal charge rule is gone and LECs are entering new, potentially competitive markets. Without such protections, price cap regulation would not satisfy the requirements of the Communications Act.

As noted above, the crux of the LECs' case for radical change to the LEC price cap scheme is that they must have completely deregulated prices in order to meet increasing local competition. Although they do not say so outright, the necessary premise of their request for pricing flexibility is that their existing rates are too high to be competitive, or that the LECs need the freedom to discriminate for other reasons.

Although WilTel does not deny that LEC access rates are excessive, the LECs are conspicuously silent regarding why rates that presumably were lawful

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9/ Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 4 FCC Rcd 2873, 2877, 2878 (1989).

when filed have suddenly become too high. If the reason the rates are too high is that they contain embedded network costs that would not be incurred by a competitor entering the market today, then the FCC should address that problem head on, rather than allowing the LECs to quietly force the embedded costs of the network on customers lacking competitive alternatives.

WilTel supports flexibility for LECs to move rates downward to meet competition, so long as rates for services that do not face competition are also adjusted downward. As WilTel observed in its opening comments, forward-looking costing methodologies are a sound basis for setting rates. 10/ But when forward-looking costing methods are applied selectively, discrimination is the necessary result. If LECs want to set rates based on forward-looking costs, they must do so across the board. The problem arises when pricing flexibility ignores resulting discrimination.

Zone density pricing illustrates the dangers of both discrimination and anticompetitive pricing that can come from pricing flexibility that ignore cost. The existing zone density rules effectively permit LECs to lower prices only in central offices where they face competition and only for the high volume services for which they face competition. However, even though tandem-switched service is also cheaper to provide in high-density offices, there is no current requirement that LECs lower prices for such services in a high-density zone when it lowers prices in that zone for high volume services. 11/ The zone density plan adopted by the FCC ignored the cost savings the LECs realize for tandem-switched traffic in high

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10/ WilTel Comments at 30-31.

11/ WilTel has made these points in filings in other proceedings. See, e.g., WilTel Petition for Reconsideration in Docket 91-213, filed April 4, 1993. See also WilTel's comments in this proceeding at 21, 32.

density offices, and thus it sanctioned LEC price discrimination against lower-volume IXCs who have no competitive alternatives to buying LEC-provided tandem-switched access. 12/

In fact, we believe that the room for such pricing flexibility is excessive, and has already led to price discrimination in favor of the largest LEC customers for transport. As we have shown in our opening comments in this docket and in other proceedings, that discrimination is harmful to long distance competition, and is likely to become more of a threat to competition if the BOCs are allowed to provide interLATA service. Unless all purchasers of access have equal competitive alternatives, or are able to self-supply access, price discrimination in the access market will affect competition in the downstream long-distance market. 13/

In sum, the FCC need not adopt the LECs' proposals for virtual deregulation of LEC pricing in order to accord the LECs any necessary flexibility in pricing to meet competition. The FCC's obligation under the Communications Act remains the same, even under price caps: to ensure that rates are just, reasonable, and nondiscriminatory. Just because the LECs may be facing the beginnings of competition does not mean that the FCC can abandon that statutory imperative.

12/ The alternative of aggregating traffic so that small IXCs can take advantage of lower direct-trunked transport rates has not proved to be satisfactory in most instances. Moreover, it is unfair to force competing companies to share facilities as the price for obtaining discounts that are automatically available to individual companies with higher traffic volumes. In addition, while it is true that the Commission has ordered LECs to provide tandem signaling service, it will be a long time, if ever, before competitive tandem-switched access services are widely available.

13/ See WilTel Comments at 10, citing Katz, Michael L., "The Welfare Effects of Third Degree Price Discrimination in Intermediate Good Markets," American Economic Review, March 1987, at 154.

V. There is No Basis For Lifting Sharing Obligations; Overall Rate Levels Should Be Reduced to a Level Closer to Cost.

The LECs have offered no convincing justification for abandonment of a sharing obligation for price cap LECs. Because the LECs continue to have monopoly control over most, if not all, of the costs and services in the interstate jurisdiction, they should not be allowed to keep excess earnings without sharing those earnings, at least in part, with ratepayers. As discussed above, even if transport and special access services become competitive (a highly speculative assumption in many markets), and even if there is local loop competition, 90 percent of all switched access revenues will continue to be immune from competitive pressures. The FCC must not now, or in the future, remove limits on overall price cap rate levels. Without such limits, LEC prices -- which are for the most part insulated from competitive pressures -- cannot be deemed just and reasonable within the meaning of Section 201(b) of the Communications Act. In addition, price cap levels that are set above cost only magnify the already significant opportunity for LEC discrimination under the price cap plan.

The premise of the price cap approach -- which caps prices and allows LECs to keep their extra earnings above the cost of capital -- is to provide incentives to LECs to become more efficient. But because it is next to impossible to determine with precision the productivity factor for each LEC, the sharing and low-end adjustment mechanisms are a necessary part of price caps for a monopoly carrier. Otherwise, the LEC would keep the benefit of any errors in calculating the productivity factor. Sharing also returns some of the benefits of the price cap scheme to monopoly ratepayers. This is properly so, since rates now are allowed to exceed actual costs, even though LECs face no competition for most of their services.

WilTel supports the arguments made by commenters such as AT&T, MCI, and the Ad Hoc Telecommunications Users Committee regarding raising the